THE POLUMBUS CORPORATION

IBLA 75-630 Decided October 30, 1975

Appeal from decision holding that oil and gas lease Colorado 1039 had terminated by operation of law.

Affirmed.

1. Oil and Gas Leases: Production -- Oil and Gas Leases: Rentals -- Oil and Gas Leases: Well Capable of Production

An oil and gas lease on which there is no well capable of production in paying quantities will terminate by operation of law if the annual rental payments are not submitted on or before the anniversary date. A well capable of production in paying quantities on the anniversary date is one which can actually produce enough oil to exceed the cost of its extraction. Neither the production of water nor the production of meager quantities of oil, albeit with hopes for paying production at some time in the future, constitute production in paying quantities on the anniversary date of the lease.

2. Oil and Gas Leases: Rentals -- Oil and Gas Leases: Termination -- Rules of Practice: Generally

Where a lessee fails to pay the annual rental on or before the anniversary date, and where the lessee knew, or should have known, that the payment was due, estoppel will not operate to relieve the lessee of the consequent automatic termination of the lease.

APPEARANCES: Richard H. Bate, Esq., of Nelson, Harding, Marchetti, Leonard & Tate, Denver, Colorado, for appellant.

OPINION BY ADMINISTRATIVE JUDGE STUEBING

The Polumbus Corporation appeals from the May 7, 1975, decision of the Colorado State Office, Bureau of Land Management (BLM), holding that oil and gas lease C-1039 had expired by operation of law for failure of appellant to pay annual rental on or before March 1, 1975, the anniversary date of the lease. The pertinent statute provides that "* * * upon failure of a lessee to pay rental on or before the anniversary date of the lease, for any lease on which there is no well capable of producing oil or gas in paying quantities, the lease shall automatically terminate by operation of law * * *." 30 U.S.C. § 188(b) (1970).

Appellant argues that there is indeed a well capable of production in paying quantities on the leasehold. In the alternative, appellant argues that departmental precedent precludes a finding that the automatic termination provisions of 30 U.S.C. § 188(b) (1970), are applicable in this instance.

[1] A well capable of producing oil and gas in paying quantities on the anniversary date of the lease is a well which is literally capable of production in paying quantities on that date. Potential production is not sufficient to satisfy the statutory requirement of capacity for present production in paying quantities.

> The courts have defined "paying quantities" as such quantity of oil or gas as will pay a profit to the lessee over and above the cost of operating the well or wells and of marketing the product. Benedum-Trees Oil Co. v. Davis, 107 F. (2d) 981, cert. denied, 310 U.S. 634 (1940); Summers, Oil and Gas (perm. ed.), sec. 306. A mere semblance of production is not enough. Kyle v. Wadley, 24 F. Supp. 884, 887 (1938).
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> The amount of gas produced under the Stebbins lease before December 31, 1944, was so nominal, and its use was of such a nature, that it cannot be regarded as production in paying quantities, as that term has been defined by the courts.
>
> The mere fact that a well on the leased lands was capable of producing gas at the end of the primary term did not satisfy the requirement that there must be production of oil or gas "in paying quantities" in order

> to extend that term. * * * The quoted phrase obviously refers to actual, not potential, production.

Solicitor's Opinion, 60 I.D. 260, 263 (1948).

Holdings in other cases lend support to this interpretation. For example, in Arlyne Lansdale, 16 IBLA 42 (1974), this Board held that where a well was not physically capable of production due to failure to complete perforation of the casing, the well was not capable of present production.

It is clear that appellant's well was not capable of production in paying quantities on the anniversary date. Initial tests indicated that the well would produce 2.08 barrels of oil per day and 84 barrels of water. From completion of the well in June 1974 to June 1975, the well pumped for a total of 87 days and produced 66 barrels of oil, or three-quarters of a barrel per pumping day. Most of the oil which was recovered was oil introduced into the well by appellant for fracturing purposes. Thus, a portion of even the small reported volume represents twice-produced oil. Nevertheless, appellant states that the well is capable of production in paying quantities, saying:

> * * * This opinion is based on inferences to be drawn from facts known about the producing structure from wells on adjoining leases which indicate that the Government 1-19 well will continue to produce mostly water and a little oil until water has been pumped out for a sufficient period of time and at a sufficient rate to produce a "cone" in the water table permitting oil to flow downward to the perferations [sic] in the production casing. It is apparent that the District Engineer considered only the initial production from the well in arriving at his opinion that the well was not capable of producing in paying quantities, but the Kerr McGee decision established that the term "capable of producing in paying quantities" means capable of producing in sufficient quantities to pay the lessee a profit, though small, over operating and marketing expenses. Obviously the determination whether a well is capable of such production cannot be made from an initial production test, or even production records for several months, if there is reason to believe that production will increase later after water is pumped out of the formation. Even the fact that initial production is insufficient to pay day-to-day operating costs does not detract from this principle.

Appellant's Brief at 3.

For all practical purposes, appellant concedes that the well could not literally have produced oil in paying quantities on the anniversary date of the lease. It is clear that the water which must be pumped out is an impediment to the possibility of production of oil in paying quantities, as well as an added cost factor. Until that impediment is removed, oil cannot be produced in paying quantities, if at all. Therefore, the lease must be considered to have terminated, as there was no well on the leasehold on the anniversary date capable of production in paying quantities. See Arlyne Lansdale, supra; Carl Losey, A-30153 (December 4, 1964); Joseph C. Sterge, 70 I.D. 375 (1963); United Manufacturing Co., 65 I.D. 106 (1958).

[2] Appellant argues alternatively that the Department is precluded from holding that the lease terminated due to precedent to the contrary, citing Husky Oil Co., 5 IBLA 7, 79 I.D. 17 (1972), and Transco Gas and Oil Corp., A-28363 (August 2, 1960). In Husky and Transco, the Department stated that an oil and gas lease will not terminate due to untimely payment of annual rental if the lessee could not have known that the rental was due. For example, in Husky, due to approval of a unit agreement a portion of the original lease was segregated into a separate lease. Annual rental did not have to be paid on the original lease as it contained a well capable of production in paying quantities. However, there was no well on the newly created separate lease, and consequently, payment of annual rental was required. Even though the annual rental was due no later than May 1, 1970, appellants were not informed of the creation or number of the new lease until after the anniversary date. Since the appellants in that case could not have known that rental payments were due, the Department held that the leases never terminated. While the decision in Husky is clearly correct, it should be noted that the rationale in that case is based partially on the rationale of two older departmental decisions, to wit, Transco Gas and Oil Corp., supra; and Solicitor's Opinion, supra. In that case the Solicitor held that the automatic termination provisions of 30 U.S.C. § 188(b) would not apply to particular circumstances where the lessee's confusion about his obligation to pay advance rental was attributable to the ambiguity in the pertinent regulations, which have since been clarified by amendment. In discussing the automatic termination provisions the Solicitor concluded:

> * * * [I]t seems apparent that Congress intended the new provision to apply to regular, annual rental payment, the necessity for which the lessee had continuous notice and that it was not intended to apply to a case where the lessee had no way of knowing that the obligation had accrued. (Emphasis added.)

64 I.D. at 336.

The other case of that genre is Transco Gas and Oil Corp., supra. The facts are very similar to those just outlined in the Solicitor's Opinion, supra, and the Department simply restated what it had said in the previous opinion.

In two more recent cases, Roy M. Eidal, supra, and Husky, however, the status of the leases involved had been changed retroactively from royalty status to rental status. Appellants in those cases were not notified of the changes until after the anniversary date. As a matter of fact, in those cases, appellants literally had "no way of knowing" that the obligation to pay rental had accrued until it was too late.

We believe that the principle set forth in Husky, Eidal, Transco, and Solicitor's Opinion is sound, although we cannot agree that it was clearly appropriate to the circumstances prevailing in Transco and Solicitor's Opinion.

While not specifically expressed as such, the instant appeal is framed so as to suggest that equitable estoppel will lie against the United States, based upon appellant's professed ignorance of any reason to believe that rental was owed, and the failure of the Geological Survey to make the determination that the well was not capable of production in paying quantities until after the rental was due. The tests to be applied in cases of this nature are set forth and discussed in United States v. Lazy FC Ranch, 481 F.2d 985 (9th Cir. 1973); Brandt v. Hickel, 427 F.2d 53 (9th Cir. 1970); United States v. Georgia-Pacific Co., 421 F.2d 92 (9th Cir. 1970); Boyd L. Marsing, 18 IBLA 197, 219 (1974) (concurring opinion). The specific tests set forth in Georgia-Pacific are:

> * * * (1) The party to be estopped must know the facts; (2) he must intend that his conduct shall be acted on or must so act that the party asserting the estoppel has a right to believe it is so intended; (3) the latter must be ignorant of the true facts; and (4) he must rely on the former's conduct to his injury.

421 F.2d at 96.

Estoppel will not lie in the present case. The salient facts in the present case are as follows. The anniversary date of the lease is March 1. The lease was extended for a second time due to diligent drilling operations conducted during February and March 1974. The well was completed in June 1974. From June 1974 to June 1975, the well produced 66 barrels of oil. Apparently, most of the oil recovered was oil that had been introduced into the well for fracturing purposes. None of the oil had ever been sold, nor has the United States received any royalties. Indeed, the monthly records of production of oil for sale may be summarized in one word: "zero." The Department never changed the status of the lease from rental to royalty, as no determination was ever made by the Geological Survey that the well was capable of producing oil and gas in paying quantities. On April 15, 1975, the District Engineer, Geological Survey, notified the BLM that the well was not capable of production in paying quantities. On May 7, 1975, the BLM held that the lease had terminated for failure of appellant to pay the annual rental prior to the anniversary date, March 1, 1975. Appellant was not "ignorant of the true facts," but rather was well aware of the facts which compel the determination that there was no well capable of production in paying quantities on the leasehold on the anniversary date, since it had reported those facts. While appellant may have hoped that the well would eventually be capable of production in paying quantities, it could not reasonably have believed that it was so capable on the anniversary date, or at any time prior thereto.

There was no misrepresentation of the status of the lease by anyone authorized to act on behalf of the United States, and no concealment of any material fact. There was no change in the status of the lease which the United States had a duty to communicate to the lessee; indeed, there was no change in the status at all. Appellant had neither requested a change in the status of the lease nor a determination of the capability of the well, so it cannot assert that its failure to make the rental payment was attributable to its anticipation of a favorable response. The appellant merely asserts that the United States is at fault for failing to take the initiative to appraise it of a negative fact already known to it, i.e., that its well was not capable of production in paying quantities; and that the failure of the United States to volunteer such advice prior to the anniversary date caused appellant not to pay the lease rental. This is not the reasonable reliance upon which the doctrine of estoppel, or any other form of equitable relief, is based.

Moreover, appellant had reason to know better. This same lease had previously been extended by the drilling of an unsuccessful well thereon in 1974, which did not alter the rental status or generate the kind of federal advice that appellant claims entitlement to in this instance.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

Edward W. Stuebing
Administrative Judge

We concur:

Douglas E. Henriques
Administrative Judge

Frederick Fishman
Administrative Judge